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CEA-01 DODE-00 PM-03 H-02 L-02 PA-01 PRS-01 USIA-06

AGR-05 INT-05 GSA-01 /108 W
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TO SECSTATE WASHDC 1670
INFO AMEMBASSY BANGKOK
AMEMBASSY JAKARTA
AMEMBASSY KUALA LUMPUR
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E.O. 11652: N/A
TAGS: EGEN, EFIN, RP
SUBJECT: ASSESSMENT OF 1975 PHILIPPINE ECONOMIC PROSPECTS

REF: MANILA 775

SUMMARY: EMBASSY'S REVIEW OF PHILIPPINE ECONOMY'S
PERFORMANCE IN 1974 (REFTEL) NOTED PHILIPPINE TERMS
OF TRADE WERE DETERIORATING IN SECOND HALF OF 1974
AND ECONOMIC ACTIVITY WAS SLOWING. GOVERNMENT'S AIMS
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FOR ECONOMY IN 1975 HAVE BEEN TO MAINTAIN REASONABLE

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RECORD OF ECONOMIC GROWTH AND TO AVOID BALANCE OF
PAYMENTS DIFFICULTIES. GOVERNMENT IS SEEKING TO
STIMULATE ECONOMIC ACTIVITY WITH ENLARGED DEVELOPMENT
PROGRAM AND SELECTIVELY EXPANSIONARY MONETARY AND
FISCAL POLICIES. IT PROJECTS A BETTER BALANCE OF
PAYMENTS PERFORMANCE THAN EARLIER FEARED AND INTENDS
TO FINANCE ANY DEFINIT WITH PREVIOUSLY ARRANGED CREDIT
LINES. STRENGTH IN AGRICULTURE AND CONSTRUCTION GIVE
COUNTRY GOOD PROSPECTS OF FIVE PERCENT GROWTH RATE.
EARLY REVIVAL OF PHILIPPINE MARKETS ABROAD WOULD
ENHANCE THESE PROSPECTS. WITH SHARP DROP IN INFLATION
RATE AND ADEQUATE SUPPLIES OF FOOD AND OTHER ESSENTIALS,
COUNTRY'S OVERALL ECONOMIC PROSPECTS ARE GOOD OR BETTER
DESPITE PROBLEMS OF ITS PRINCIPAL TRADING PARTNERS.

END SUMMARY.

1. STARTING POINT. PHILIPPINE ECONOMIC SITUATION
IN EARLY 1975 PROVIDES CAUSE FOR CONCERN IN SOME AREAS
AND EXPECTATIONS OF STRONG PEFORMANCE IN OTHERS.
DETERIORATION IN COUNTRY'S TERMS OF TRADE SINCE MID-1974
HAS SLOWED ECONOMIC GROWTH FROM OVER EIGHT PERCENT RATE
ENJOYED IN 1973 TO SIX PER CENT IN 1974 AND HAS PLACED
PRESSURE ON COUNTRY'S PAYMENTS BALANCE. RECENT GROWTH
IN COUNTRY'S EXTERNAL DEBT AND EXPANDING DEVELOPMENT
NEEDS PLACE LARGE BURDEN ON COUNTRY' DEBT SERVICING
CAPABILITIES. DESPITE THESE FINANCIAL WORRIES,
ECONOMY'S CAPACITY TO MEET COUNTRY' VITAL NEEDS APPEARS
STRONG. FOOD PRODUCTION HAS REACHED RECORD LEVELS
AND THE RATE OF INFLATION AT LEAST TEMPORARILY HAS
SLOWED TO AT WORST A SINGLE DIGIT. COUNTRY'S ABILITIES
TO PROVIDE TECHNICAL SUPPORT OF AND DOMESTIC FINANCING
FOR FURTHER DEVELOPMENT ARE UNUSUALLY STRONG. PHILIPPINE
SITUATION, CONSEQUENTLY, HAS CONSIDERABLE PROMISE DESPITE
CURRENT EXTERNAL DEVELOPMENTS.

2. GOALS AND POLICIES. PHILIPPINE ECONOMIC GOALS IN
1975 CENTER UPON NEED FOR ECONOMIC GROWTH AND DEVELOPMENT
TO PROVIDE EMPLOYMENT AND IMPROVED LIVING STANDARDS FOR
COUNTRY'S GROWING POPULATION. GOALS INCLUDE WIDER DIS-
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PERSION OF BENEFITS OF ECONOMIC GROWTH AND STRENGTHENING
OF ECONOMY'S RESISTANCE TO ADVERSE EXTERNAL DEVELOPMENTS.
GOVERNMENT'S DEVELOPMENT PROGRAM EMPHASIZES INFRANSTRUCTURE
EXPANSION, PARTICULARLY IN SUPPORT OF RURAL DEVELOPMENT.
PRIORITY AREAS ARE HIGHWAYS AND RURAL ROADS, IRRIGATION
AND FLOOD CONTROL FACILITIES, POWER GENERATION AND
DISTRIBUTION AND AIRPORTS, HOTELS AND OTHER TOURISM
FACILITIES. GOVERNMENT'S SECTORAL PRIORITIES ARE

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AGRICULTURE, TOURISM AND LABOR INTENSIVE MANUFACTURE, PARTICULARLY FOR EXPORTS. GOVERNMENT'S POLICY IS TO MOVE FORWARD WITH ITS DEVELOPMENT PROGRAM AND SECTORAL PRIORITIES TO MAXIMUM EXTENT PERMITTED BY COUNTRY'S ECONOMIC SITUATIONS. ITS PLANS CALL FOR FURTHER INCREASING THE SHARE OF GOVERNMENT IN THE GROSS NATIONAL PRODUCT, AND FOR INCREASING PUBLIC SPENDING ON DEVELOPMENT TO LEVELS WHICH WILL INCREASE THE STIMULUS PROVIDED BY THE PUBLIC SECTOR TO THE ECONOMY. THE GOVERNMENT ALSO PLANS ON ADDITIONAL FOREIGN BORROWINGS TO SUPPORT ITS DEVELOPMENT PROGRAM AND TO COVER AN ANTICIPATED 1975 BALANCE OF PAYMENTS DEFICIT ON CURRENT ACCOUNT.

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CEA-01 DODE-00 PM-03 H-02 L-02 PA-01 PRS-01 USIA-06

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R 260743Z MAR 75
FM AMEMBASSY MANILA
TO SECSTATE WASHDC 1671
INFO AMEMBASSY BANGKOK
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3. PRODUCTION PROSPECTS. PHILIPPINE PRODUCTION
PROSPECTS FOR 1975 ARE ENCOURAGING. AGRICULTURE IS
EXPECTED TO CONTINUE ITS RECENT GROWTH RECORD.
THE GOVERNMENT SUPPORTS THIS SECTOR WITH CONTINUING
HIGH PRIORITY ON ADDITIONAL INFRASTRUCTURE AND RECORD
AMOUNTS OF CREDIT AND FERTILIZER. IN THE ABSENCE OF
OVERRIDING WEATHER INFLUENCES, RICE PRODUCTION IS
EXPECTED TO EXCEED LAST YEAR'S RECORD CROP, ALTHOUGH
TOTAL SUPPLY WILL YIELD ONLY A NOMINAL SELF-SUFFICIENCY.
PRODUCTION OF COPRA, COCONUT OIL AND OTHER COCONUT
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PRODUCTS IS EXPECTED TO RISE ABOUT 40 PERCENT. WHILE
SUGAR PRODUCTION DURING THE 1974-75 CROP YEAR IS
UNOFFICIALLY, AND POSSIBLY CONSERVATIVELY, ESTIMATED
AT ABOUT LAST YEAR'S LEVEL, THE 1975-76 CROP IS
EXPECTED TO BE SIGNIFICANTLY HIGHER AS SOME NEW MILLING
CAPACITY ENTERS PRODUCTION MAINLY BE ENCHANCEMENT OF
EXISTING CENTRALS. BANANAS, PINEAPPLES AND OTHER
LESSER PRODUCTS ARE EXPECTED TO SHOW GOOD GROWTH, ALTHOUGH
EXTERNAL DEMAND CONDITIONS MAY REMAIN SLUGGISH. LOG AND
LUMBER PRODUCTION IS EXPECTED TO INCREASE OVER THE
DEPRESSED 1974 LEVEL, BUT OUTPUT WILL STILL FALL CONSI-
DERABLY SHORT OF 1973. PROMOTED ACTIVELY BY THE
GOVERNMENT AS A MEANS TO REDUCE UNEMPLOYMENT, AND
STIMULATED BY DEMANDS FOR INFRASTRUCTURE, HOUSING AND
TOURIST FACILITIES, THE MOST RAPIDLY GROWING SECTOR IS
EXPECTED TO BE CONSTRUCTION. THE SCALE OF ACTIVITY
IN INFRASTRUCTURE CREATION WILL BE UP SHARPLY. CONSTRUCTION
OF TOURISM FACILITIES WILL EXPAND SHARPLY OVER THE
REMAINDER OF THIS YEAR AND WILL REMAIN AT HIGH LEVELS
WELL INTO 1976. COMMENCEMENT OF PRODUCTION AT THE
MARINDUQUE NICKEL PROJECT WILL INCREASE MINING PRODUCTION,
BUT THIS INCREASE IS LIKELY TO BE OFFSET BY DECLINES
IN PRODUCTION OF COPPER CONCENTRATES PARTLY FORCED
BY CUTS IN RATES OF OFFTAKE UNDER JAPANESE CONTRACTS.
MANUFACTURING PRODUCTION IS NOT EXPECTED TO IMPROVE
SHARPLY ON LAST YEAR'S SIX PERCENT GROWTH RATE IN
THE ABSENCE OF AN EARLY UPTURN IN DEMAND ABROAD FOR
TEXTILES, ELECTRONICS AND OTHER MANUFACTURED GOODS,
ALL SECTORS OF OUTPUT WHICH WERE BEGINNING TO FLOWER
WITH THE ONSET OF THE ENERGY CRISIS. THE PHILIPPINE
GROWTH RATE TARGET FOR 1975 IS SEVEN PERCENT, A FIGURE
WHICH SENIOR GOVERNMENT OFFICIALS WILL PRIVATELY
CONCEDE TO BE OPTIMISTIC. NEVERTHELESS, THE ECONOMY'S
UNDOUBTED STRENGTH AND THE GOVERNMENT'S SELECTIVELY
EXPANSIONARY POLICIES PUT A FIVE PERCENT GROWTH RATE
WELL WITHIN THE ECONOMY'S REACH.

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4. INFLATION. THE PHILIPPINE GOVERNMENT'S DECLARED
INTENTION TO PURSUE SELECTIVELY EXPANSIONARY MONETARY
AND FISCAL POLICIES DURING 1975 OCCASIONS CONCERN ABOUT
PROSPECTIVE PHILIPPINE INFLATION RATES, BUT THIS POLICY
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FACES FEWER SOURCES OF EXTERNAL INFLATIONARY PRESSURE
THAN BESET THE CONOMY IN EARLY 1974. AFTER RISING
TO ANNUAL RATES OF 40 PERCENT AND ABOVE DURING FIRST
HALF OF 1974, THE WIDELY CITED CENTRAL BANK COST OF
LIVING INDEX FOR MANILA HAS SHOWN NO SIGNIFICANT MOVEMENT
BETWEEN LAST SEPTEMBER, AND THIS FEBRUARY. INDEX'S
STABILITY IS MAINLY ATTRIBUTABLE TO A SHARP DECLINE
IN FRUIT AND VEGETABLE PRICES, SOME SETTLING OF CEREAL
PRICES AND MINOR INCREASES IN OTHER PRICES.

THE GOVERNMENT'S FISCAL 1975 BUDGET CALLS FOR A
DEFICIT OF P3.0 BILLION ($440 MILLION), TO BE MET
PRINCIPALLY BY PRIVATE SECTOR BORROWINGS. ITS RECENTLY
ANNOUNCED FY 1976 BUDGET CALLS FOR EXPENDITURES OF
P22 BILLION, OF WHICH ABOUT P5 BILLION IS SCHEDULED TO
BE MET BY BORROWINGS. ALTHOUGH GOVERNMENT CASH OPERATIONS
HAVE RECENTLY SHOWN SMALLER DEFICITS THAN PROJECTED IN
THE BUDGET BECAUSE OF LAGS IN PROJECT IMPLEMENTATION,
THE FISCAL STIMULUS WILL BE SIGNIFICANT. THE 1976 BUDGET
CALLS FOR DEVELOPMENT EXPENDITURES OF P8.0 BILLION, OR
40 PERCENT OF THE BUDGET.

SIGNIFICANT INCREASES IN MILITARY SPENDING ALSO
WILL CONTRIBUTE TO AN EXPANSIVE EFFECT OF THE BUDGET.
THE FISCAL 1975 BUDGET CALLED FOR DEFENSE EXPENDITURES
OF P2.2 BILLION ($320 MILLION). ALTHOUGH FIRM ESTIMATES
ARE NOT AVAILABLE, INCREASES IN FORCE LEVELS, HIGHER
PRICES FOR EQUIPMENT AND MATERIAL, SALARY AND WAGE
INCREASES AND GREATER THAN ANTICIPATED PROCUREMENT OF
NEW EQUIPMENT COULD CAUSE MILITARY EXPENDITURES
MATERIALLY TO EXCEED THE EARLIER BUDGET FIGURE.
THE FY 1976 BUDGET, IN FACT, CALLS FOR DEFENSE
EXPENDITURES OF P3.3 BILLION, 15 PERCENT OF
GOVERNMENT BUDGET EXPENDITURES.

GOVERNMENT POLICIES HAVE ENCOURAGED TOTAL
LIQUIDITY IN THE MONETARY SYSTEM TO EXPAND AT A
20 PERCENT ANNUAL RATE OVER THE PAST FEW MONTHS,
WHILE HOLDING MONEY SUPPLY EXPANSION TO LESS THAN
15 PERCENT. PHILIPPINE INTEREST RATES ARE CURRENTLY
IN 15 PERCENT TO 18 PERCENT RANGE, INDICATING CON-
SIDERABLE EASE IN MONETARY MARKETS. HOWEVER,
GOVERNMENT'S EXPANSIONARY FISCAL POLICIES CONTEMPLATE
SHARP INCREASE IN PUBLIC SECTOR BORROWINGS FROM
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PRIVATE SOURCES DURING 1975. RISING LEVEL OF PUBLIC SECTOR BORROWINGS IS EXPECTED PLACE INCREASING PRESSURES ON AVAILABILITY OF FUNDS FOR PRIVATE SECTOR AND ON POLICY TARGETS FOR GROWTH IN MONEY SUPPLY AND OVERALL LIQUIDITY.

DECLINING EXPORT PRICES AND STABILIZING IMPORT PRICES PROVIDE ENCOURAGEMENT THAT INFLATION FROM THESE SOURCES WILL BE MINIMAL IN 1975. HOWEVER, THE ALREADY ACKNOWLEDGED PROSPECT OF SOME FURTHER ADJUSTMENT IN RELATIVE INCOME SHARES, INCLUDING WAGE INCREASES FOR URBAN WORKERS, AND THE EFFECTS OF THE GOVERNMENT'S EXPANSIONARY MONETARY AND FISCAL POLICIES, WILL PUT PRESSURE ON PRICES. THE GOVERNMENT IS UNDERSTOOD TO BE AIMING AT AN ANNUAL INFLATION RATE OF 10 TO 15 PERCENT. ALTHOUGH THERE HAS BEEN A WIDE DIVERGENCE OF VIEW ON THIS ISSUE WITHIN GOP, IT PROBABLY NOW VIEWS A RATE IN 10-15 PERCENT RANGE AS SOCIALLY AND ECONOMICALLY TOLERABLE. INFLATION RATES IN 1973 AND 1974 VASTLY EXCEEDED GOVERNMENT'S TARGETS, BUT CONDITIONS ARE SHARPLY DIFFERENT IN 1975. WITH THE ECONOMY STRUGLLING TO MAINTAIN A DECENT GROWTH RATE, GENERATION OF EITHER STRONG DEMAND PULL OR NEW SOURCES OF COST PUSH INFLATIONARY PRESSURE APPEARS IMPROBABLE. WHILE PRESENT GOVERNMENT POLICIES PRESUPPOSE RESUMPTION OF SOME PRICE INFLATION, PROSPECTS THAT THE GOVERNMENT CAN HOLD INFLATION REASONABLY CLOSE TO THE DESIRED RANGE APPEAR PROMISING.

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AGR-05 INT-05 GSA-01 /108 W
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R 260743Z MAR 75
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5. BALANCE OF PAYMENTS. PHILIPPINE BALANCE OF PAYMENTS PROSPECTS FOR 1975, ALTHOUGH IMPAIRED BY A DECLINE IN THE TERMS OF TRADE, ARE PROBABLY BRIGHTER THAN IMMEDIATE TRADE PROSPECTS INDICATE. THE MAJOR EXPORT EARNER AGAIN WILL BE SUGAR. UNOFFI-CIALLY THE GOVERNMENT HAS PROJECTED SUGAR EARNINGS AT $800 MILLION, ABOUT THE SAME AS LAST YEAR, ON THE BASIS 1.5 MILLION TONS OF EXPORTS AT AN AVERAGE PRICE OF $550 PER TON. THIS PROJECTION COULD PROVE OPTIMISTIC
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AS PRICES ON SIX MONTH FORWARD SALES RECENTLY DIPPED BELOW $550 FIGURE. HOWEVER, THE PROJECTED VOLUME OF SUGAR EXPORTS IS BELIEVED CONSERVATIVE. COCONUT PRODUCTS, EXPORTS OF WHICH TOTALLED OVER $650 MILLION IN 1974, WILL BE THE SECOND MAJOR EXPORT. DUE IN PART TO LOCAL INCREASES IN OUTPUT, THE QUANTITY OF THESE EXPORTS COULD BE UP AS MUCH AS 15 PERCENT, BUT PRICE DECREASES COULD CAUSE EXPORT RECEIPTS TO DECLINE AS IN EARLIER YEARS. CURRENT MANILA OFFERS OF COCUNUT OIL AT 20 CENTS PER POUND COMPARE WITH 49 CENTS PER POUND IN MARCH 1974. MARINDUQUE NICKEL IS EXPECTED TO ADD $75 TO $100 MILLION TO EARNINGS FROM MINERAL EXPORTS. COPPER PRICES ARE BELIEVED TO HAVE REACHED A FLOOR AT ABOUT 55 CENTS PER POUND BUT RECENT GOVERNMENT REMOVAL OF COPPER EXPORT PREMIUM TAXES HAS PULLED THE INDUSTRY BACK INTO THE BLACK. PHILLIPPINE EARNINGS FROM COPPER CONCENTRATES WILL UNDOUBTEDLY BE DOWN FROM 1974 LEVELS, BUT THE EXTENT OF

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DECLINE WILL DEPEND HOW FAR THE JAPANESE WILL FINALLY CUT BACK PURCHASES. ANY REAL INCREASE IN LOG AND LUMBUR EXPORTS OVER THE DEPRESSED 1974 LEVEL WILL DEPEND ON THE SPEED OF RECOVERY OF U.S. AND JAPANESE HOUSING INDUSTRIES.

WITH ONLY MODEST GROWTH PROJECTED IN OTHER EXPORTS, THE GOVERNMENT HAS INTERNALLY PROJECTED TOTAL EXPORT EARNINGS OF $2.8 BILLION IN 1975, AN INCREASE OF 3.7 PERCENT FROM 1974 EXPORTS OF $2.7 BILLION. ON THE ASSUMPTIONS THAT RECENT STEADYING OF IMPORT PRICES WILL PERSIST AND THAT INCREASES IN IMPORT DEMAND WILL BE IN THE FIVE PERCENT RANGE, IMPORTS HAVE BEEN PROJECTED AT $3.3 BILLION. THE RESULTANT PROJECTED TRADE DEFICIT OF $500 MILLION WOULD BE THE LARGEST IN PHILIPPINE HISTORY. HOWEVER, THE TRADE DEFICIT IS EXPECTED TO BE LARGELY OFFSET BY AN INVISIBLES SURPLUS, PROJECTED BY THE GOVERN-MENT AT $350 MILLION, MAINLY ON THE BASIS OF RISING TOURISM EARNINGS, EMIGRANTS' REMITTANCES AND CONTINUING U.S. MILITARY BASE EXPENDITURES, AND VETERAN'S AND SOCIAL SECURITY PAYMENTS. A PROJECTED CURRENT ACCOUNT DEFICIT OF $150 MILLION MAY BE ON THE OPTIMISTIC SIDE BUT WE DO NOT AT THIS STAGE BELIEVE THE PHILIPPINE BALANCE OF PAYMENTS WILL BE UNDER SEVERE STRAIN DURING 1975.
THE CREDIT LINES PRESENTLY AVAILABLE TO THE PHILIPPINES
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ARE MORE THAN ADEQUATE TO COVER A CURRENT ACCOUNT DEFICIT OF UP TO $300 MILLION, AND THE COUNTRY'S LONG-TERM CAPITAL ACCOUNT IS EXPECTED TO REMAIN IN ROUGH BALANCE.

6. EXTERNAL DEBT. EXTERNAL DEBT INCREASED SHARPLY DURING 1974 TO $3.2 BILLION. MUCH OF THE $800 MILLION INCREASE CONSISTED OF REVOLVING CREDITS NECESSARY TO FINANCE THE OIL PRICE AND OTHER INFLATION SWOLLEN IMPORT BILL. THE GOVERNMENT ANTICIPATES THAT FURTHER BORROWING WILL BE NECESSARY IN1975 TO COVER THE CURRENT ACCOUNT DEFICIT, REPAYMENT OF EXISTING DEBT AND FOREIGN EXCHANGE COSTS OF THE EXPANDED DEVELOPMENT PROGRAM. EXISTING AND PROSPECTIVE BORROWINGS AND POSSIBILITIES FOR OTHER STRESSES ON THE BALANCE OF PAYMENTS HAVE LED TO SOME CONCERN, AGGRAVATED NO DOUBT BY RECOLLECTIONS OF DEEP PHILIPPINE EXTERNAL DEBT PROBLEMS IN 1968-1970, ABOUT THE ECONOMY'S CAPACITY TO ABSORB FURTHER SIZEABLE DEBT. HOWEVER, THE GOVERNMENT IS NOW REQUIRED BY STATUTE AS WELL AS ITS STANDBY ARRANGEMENT WITH THE INTERNATIONAL MONETARY FUND TO PREVENT DEBT SERVICE COSTS FROM EXCEEDING 20 PERCENT OF CQMRENT ACCOUNT EARNINGS. THE GOVERNMENT PROJECTS A DEBT SERVICE RATIO OF 17 PERCENT FOR FISCAL 1975. MUCH OF

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THE GOVERNMENT'S SUCCESS IN MANAGEMENT OF EXTERNAL DEBT
IS OWED TO THE HIGH POLICY PRIORITY ATTACHED TO THIS
GOAL AND TO THE RISING FLOW OF ECONOMIC ASSISTANCE
FROM MEMBERS OF PHILIPPINE CONSULTATIVE GROUP. THESE
TWO ARE AND HAVE BEEN, OF COURSE, CLOSELY RELATED.

THE STRUCTURE OF PHILIPPINE EXTERNAL DEBT HAS
VASTLY IMPROVED OVER 1970. ABOUT $2 BILLION OR 60 PERCENT
OF THE PRESENT DEBT INVOLVES ORIGINAL BORROWINGS
OF MORE THAN FIVE YEARS. IN 1974 ALONE MEMBERS OF THE
PHILIPPINE CONSULTATIVE GROUP COMMITTED ABOUT $424 MILLION
IN LONG-TERM LOANS. AVERAGE MATURITIES OF BORROWINGS
FROM PRIVATE FOREIGN SOURCES HAVE ALSO LENGTHENED. THE
CENTRAL BANK HAS OBTAINED FIVE YEAR TERMS FOR $650 MILLION
IN REVOLVING CREDIT OBTAINED LAST YEAR TO FINANCE INCREASED
COSTS OF PETROLEUM AND OTHER IMPORTS.

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BOTH THE NEED FOR AND THE ABILITY OF THE PHILIPPINES
TO ABSORB CAPITAL ARE UNDOUBTEDLY GROWING. THE EXTENT
TO WHICH IMMEDIATELY FORSEEABLE PHILIPPINE CAPITAL NEEDS
CAN BE MET WILL DEPEND HEAVILY UPON THE AVAILABILITY
OF ECONOMIC ASSISTANCE. BOTH IBRD AND ADB AND OTHER
CONSULTATIVE GROUP MEMBERS ARE EXPECTED TO CONTINUE
TO SUPPORT AND EXPAND LENDING TO THE PHILIPPINES.
COMMERCIAL BORROWINGS HAVE, NEVERTHELESS, AN INCREASINGLY
DOMINANT ROLE TO PLAY IN PHILIPPINE DEVELOPMENT PLANS,
AND THE ECONOMY'S CONTINUING ABILITY TO ATTRACT SUCH
SUPORT IS AT LEAST AS CRUCIAL FOR THE COUNTRY'S
DEVELOPMENT AS ITS ABILITY TO SERVICE SIGNIFICANTLY
GREATER DEBT, ALTHOUGH NEITHER SEEMS TO POSE A
SIGNIFICANT HURDLE IN 1975.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, ECONOMIC REPORTS, ANNUAL REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 26 MAR 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: GolinoFR
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975MANILA03811
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
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Handling Restrictions: n/a
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Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 9
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 75 MANILA 775
Review Action: RELEASED, APPROVED
Review Authority: GolinoFR
Review Comment: n/a
Review Content Flags:
Review Date: 17 JUN 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <17 JUN 2003 by KelleyW0>; APPROVED <18 JUN 2003 by GolinoFR>
Review Markings:

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Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ASSESSMENT OF 1975 PHILIPPINE ECONOMIC PROSPECTS
TAGS: EGEN, EFIN, RP
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006